MARKET ANALYSIS OF SECURITIES OF REITS AND REAL ESTATE COMPANIES

Audit's Realty Stock Review

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MARKET STRATEGY: THE FLIP SIDE OF LOWER OPERATING EPS IS HIGHER CAPITAL GAINS

It's no secret that operating earnings and cash flow for many REITS -- including the four institutional REITs reviewed this issue -- are showing clearly the impact of lower inflation, interest, and rentals. For each of the four, their latest-year percentage gains (or declines) in operating EPS are well below five-year trends, as follows:

	Oper.	--% Chng. Last--	
Trust/Yr.	EPS/CFS	1 Yr.	5 Yrs.
BankAmer./July..	$2.26	+4.2%	+ 7.9%
MONY Rlty/May...	0.76	-24.4	- 1.4
Prop.Cap./July..	1.63	+6.5	+ 8.0
Wells Far./June.	1.58	-19.4	+ 4.8

But beneath the numbers is another story: the emergence of capital gains as a growing source of income for REITs. When you think about it, that makes sense. For the rising rents of recent years served to boost values well above the cost basis of properties, creating loads of unrealized appreciation.

Despite gloomy media forecasts, the fall in inflation hasn't eroded most unrealized gains. Major visible declines in property values are largely confined to oil patch properties; values remain strong in most other markets because much lower capitalization rates for income have offset lower rents (see review of Bay Financial, RSR, Sept. 12).

So it's no surprise that these institutional REITs (and many others) are harvesting some of their lush capital gains. Here's a table showing this harvest of gains in the last year and last five years, as a percentage of total income, plus our estimate of how much unrealized appreciation remains:

	-Last year-		-5 Years-		Unreal.
	Gain	%Tot.	Gain	%Tot.	Gains
BankAmer..	$1.86	45%	$4.18	29%	$14.55
MONY Rlty.	0.03	4	0.58	7	1.50
Prop.Cap..	0.24	13	0.84	11	E6-8.00
Wells Far.	0.84	35	4.24	34	9.12

The rub comes when a REIT comes to depend upon this harvest for dividend payouts. When that happens, investors face the potential that any slip in closing sales could lead to dividend cuts and likely lower stock prices.

Of the four trusts reviewed, **Wells Fargo Mtg.** has relied on gains for about 10%-20% of payout the last three years. **MONY Realty** has used gains for 7%-14% of payout the last two years. Operating funds have covered payout 100% for **BankAmerica Realty** for all but the latest year, when 7.5% of payout represented gains. **Property Capital** doesn't pay out gains, preferring to roll appreciation forward via tax-deferred exchanges, a device also used by BankAmerica Realty.

RANKING REVIEW ISSUE

REVIEWS OF STOCKS

Stock charts courtesy R.W. Mansfield Co.

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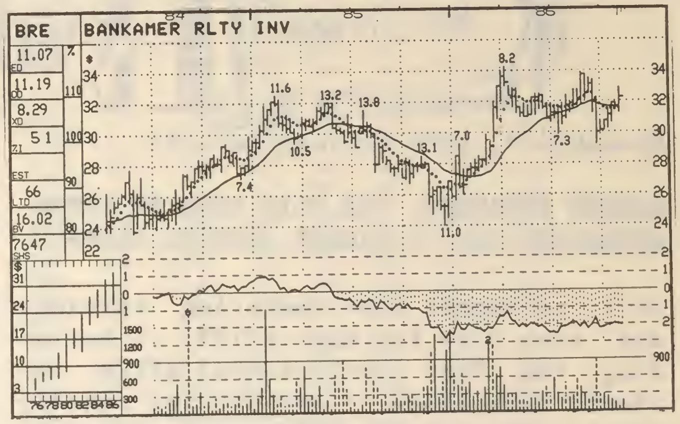
RANKING REVIEWS: BANKAMERICA REALTY, PROP. CAPITAL HOLD A; TWO HOLD B RANK



BankAmerica Realty Investors (32-7/8--NYSE) holds A Rank as a major institutional combination equity and mortgage REIT. For the moment we do not see unrest in upper echelons of BankAmerica Corp. intruding upon BRE.

<u>EPS/Dividends - A</u>: EPS and dividend growth continued, again at a slower pace than in previous years. And EPS and dividends are likely to be flat in FY 1987. Operating EPS of $2.26/sh. fully diluted rose only 4.2% in the July 1986 fiscal year. Operating funds available for distribution, considered by management as the best measure of performance, fell 5.5% to $2.22 per sh., first decline in five years. Higher vacancy rates, expenses of four unoccupied buildings, and higher insurance premiums are blamed. Distributable cash has risen at 7.4% over the past five years. Dividends have risen at 13.0% annually from a much lower base. Management now foresees slower growth for 1986, and we see operating funds up perhaps only nominally. Payout was boosted to the current $2.40 annual rate in Jan. 1986 and likely will stay there until late in fiscal 1987. Shs. yield 7.4% currently.

BRE sold five investments for $1.86/sh. gain in 1986. Three were structured as tax-deferred exchanges and BRE acquired three major new projects. Since BRE generally sells mature and higher yielding investments, BRE has trouble finding new real estate to replace those higher yields. BRE has cashed $4.18/sh. sale gains the last five years and lower initial yield on replacement properties contributes to the appearance of slower growth.

<u>Assets and Operations</u>: BRE generally seeks to combine both equity and debt positions in a single property to maximize returns while cutting risk. Property holdings by current value are 39% apartments, 23% shopping center, 11% light industrial, 10% hotel, 9% warehouse/distribution, and 7% office. Substantially all are in Calif. or the West Coast. Specific property status:

Shopping centers: Home Express in Aug. occupied a vacant 50,000 SF at 498,000 SF Hub shopping center in Fremont, Cal. but at lower rents, cutting about 3.8¢ sh. from CFS. Hub is 92% occupied; General Cinema will build a major complex to add to 1988 income.

Apartments: BRE's 968 DU owned are 96.6% occupied. In 1986 BRE paid $21.1 mil. (or $52,800/DU) for the 400-DU Selby Ranch upper income apartments in Sacramento in 1986. It is 99% occupied. Land lease under 2,983-DU Country Club Apts. in Daly City, Cal. (96% occupied) is a major appreciated asset.

Industrial/Offices: BRE owns 1.24 mil. SF directly which is 87% occupied. Substantially all vacancy is in a vacant 64,000 SF building in Fremont (Silicon Valley) and two buildings with 70,000 SF in Redmond, Wash. These two vacancies cost about 16¢ sh. A Pasadena office complex, where BRE owns the land, is now 35% vacant because of overbuilding.

Hotels: BRE owns no hotels but holds land beneath three either directly or in partnerships. All are doing well. The hotel adjoining the Pasadena office improved occupancy 4% to 80% and rates rose 3.5%. Hotel Westcourt in Phoenix averages 77% occupancy and Holiday Inn-Union Square in San Francisco is at 73%.

<u>Financial Measures - A</u>: Debt of $71.6 mil. is 0.51 times shareholders' equity of $139.4 mil. or $17.74/sh. Debt is all fixed-rate with $20.5 mil. property mortgages and $51.1 mil. convertibles; fully diluted book value would be $19.95/sh. BRE has cut floating rate debt from 40% of capital to zero the last three years, thus has minimal exposure to rate increases. Liquidity is good.

<u>Current Value</u>: BRE puts current appraised value of net assets at

$34.50/sh. diluted, up 2%. Property income was capitalized at 8%-11% and the value does not include selling costs or bulk-sale discounts. Apartments were not valued at wholesale condo price.

Exposure - A: BRE's consistent access to capital markets has been used to reduce debt exposure and fund new investments. Sponsorship by a large (but somewhat troubled) U.S. bank gives it a look at major investments.

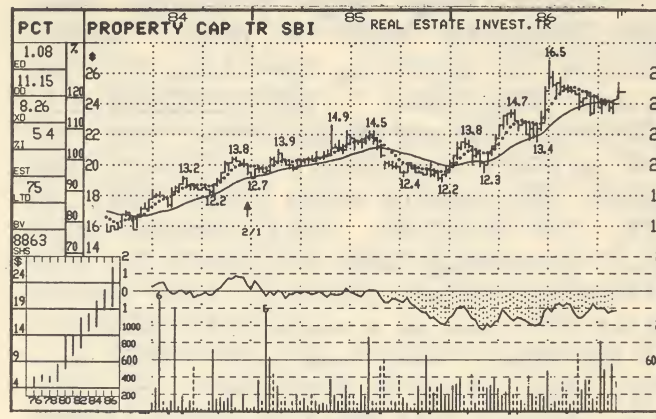
Property Capital Trust (24-3/8--ASE) also maintains A Rank. A trust with large institutional ownership, PCT has one of the longest unbroken EPS growth records among REITs.

EPS/Dividends - A: Operating EPS rose 6.5% to $1.63/sh. in PCT's July 1986 fiscal year. EPS and dividends have risen at 8.0% annually the last five years. PCT invests in land lease-backs and mortgage loans with equity participation, both providing pure income without depreciation. PCT pays 100% of operating income, so dividends mirror EPS.

In three of the last five years, PCT has reported gains on tax-deferred property exchanges which let PCT roll forward appreciation into new properties without taxes. Swap gains were 24¢ in 1986 and PCT has agreed to two exchanges to add about $2.65/sh. in 1987.

Assets and operations: Investments of $164.9 mil. are 39% leasebacks, 61% mortgages, and earned an average 10.84% base rate in 1985, down 0.49%. PCT has $38.1 mil. unfunded commitments for new investments, down 48% from 1985, with 11.0% base rate. About half of investments are subordinate to first mortgage financing which totaled $212 mil. at year-end; PCT thus has a leveraged equity interest in a total $377 mil. of properties. All leasebacks and mortgages provide for PCT to share in percentages of rent increases over base or minimum rents, and this overage income rose 18% to $5.45 mil. in 1986, or about 62¢ sh. on the assumption that all overage income falls to the bottom line. Overage income is up at 31% annually the past five years and 65% of investments earn overages.

PCT holds investments and commitments in 54 properties distributed 35%



offices, 12% shopping centers, 15% hotels, 13% industrial/commercial, 16% apartments. By location, 35% are Midwest, 36% West. Four years ago PCT, as general partner, began joining other institutional investors in major projects. PCT has committed to fund $112 mil. (31%) of $360 mil. in such projects. Two partnerships were formed in 1986 to invest $87 mil. in a San Ramon, Cal. apartment and expansion of a Chicago area Hilton hotel; PCT committed $25 mil. But during 1986 PCT terminated commitments to fund offices in Phoenix and Austin, Tex., because developers could not meet leasing commitments. In 1986 PCT funded $6.4 mil. in institutional partnerships owning nine office/retail buildings with 639,000 SF in Overland Park, Kan.; and $4 mil. in a 201,000 SF Colorado Springs office park.

PCT also invested $13.3 mil. in 500,000 SF enclosed Greeley (Col.) Mall, and $13 mil. in a 133,000 SF Chevy Chase, Md. office.

Financial Measures - A: Debt of $75.2 mil. is 0.7 times shareholders' equity of $106.8 mil. or $11.86/sh. Debt is all fixed-rate and includes $5 mil. of 6.5% senior notes and $70 mil. debentures convertible at $19 and $21.70. Fully converted capital of $177 mil. would equal $14.23/sh. Liquidity is good with $14.3 mil. cash available for $38 mil. commitments.

Exposure - A: PCT continues to combine shrewd investment strategy with sound investment selection and monitoring to minimize risks and create growing income. Because of its success, about 75% of shares are held institutionally and PCT is regarded as an institutional real estate money manager.

Wells Fargo Mtg. & Equity Trust (28-5/8--NYSE) holds B Rank, mainly because of declining operating EPS and static dividends. EPS/Dividends - B: Operating income of $1.58/sh. was off 19% in WFM's June 1986 fiscal year, and gains on property sales added 84¢, up 71%, for $2.42/sh. total income, down 1%. Operating funds available for distribution before property sale gains, which WFM uses as a measure for payouts, of $2.24/sh. were down 11%. This measure has risen at 3.3% over the past five years, and total funds available have also been flat. The $2.80 dividend has held for four years and we foresee no real changes in FY 1987.

WFM earned 41¢ in the Sept. qtr., including 7¢ sale gains, vs. 47¢.

WFM has traditionally made up the gap between operating funds and distributions with realized capital gains, but these supplemental gains have narrowed in recent years. Still, WFM has about $71.8 mil. unrealized gains in its equity holdings, equal to about $9.12/sh. fully diluted, and presumably could harvest supplemental gains for many more years to come. While gains provide some shelter to the dividend (27% tax-free return of capital, 22% capital gain in 1986), the 1986 tax reform makes this distinction less meaningful.

WFM is a balanced trust mixing equities (33% of $464.3 mil. invested assets) and mortgages (67%). Mortgages of $311 mil. are match-funded with $266 mil. floating rate debt ($50 mil. extendible notes, $216 mil. commercial paper), at locked-in spreads. Non-earning loans and foreclosures are minimal, at 0.30% of investments. Equities of $175.2 mil. before depreciation are 58% income properties owned directly; 35% partnerships divided 14% loans and 21% equity contributions; and 6% equity-sharing loans. About 75% of wholly owned equities are industrial (1.0 mil. SF--90% occupied) and office (530,000 SF--70% occupied). Joint ventures are industrial (1.43 mil. SF--86% occupied); industrial/office (1.27 mil. SF--68%).

Financial Measures - B: Debt of $321 mil. is 2.4 times equity of $135.2 mil. or $20.44/sh. As noted, about $266 mil. of debt matches to short- and intermediate term mortgages. Remaining debt is all fixed rate including $27.9 mil. debentures convertible at $25.025 per share. Fully diluted book value is $21.10/sh. Liquidity is adequate.

Current Value: WFM reports current net asset value at $30.22/sh., off 2%. To get realistic values, WFM engages several third-party appraisers familiar with local markets in which it is active to appraise properties.

Exposure - A: WFM's forward planning, sound underwriting, and ability to select from loans generated by its major bank sponsor has let it operate successfully in mortgage lending while building an equity property base.

MONY Real Estate Investors (10-3/4--NYSE) holds B Rank as it continues conversion from a mortgage into a combination equity and mortgage REIT.

EPS/Dividends - B: Operating income of this REIT sponsored by Mutual of New York Insurance Co. declined 2.6% to 76¢ in the May 1986 year; capital gains added 3¢ sh. Aug. qtr. EPS fell 24% to 16¢. Declines are generally in line with MYM's planned stress upon lower-yielding equities over mortgages. Dividends rose 5% to 88¢ annual rate.

Assets and Operations: After some decline, total assets rose 7% to $191 mil. thru Aug., now divided 27% equities and partnerships and 73% mortgages. To ease transition, MYM plans making a few 3-5 yr. mortgages on leased properties. Recent equity investments include $14.1 mil. for 133,000 SF Fairfield Commons shopping center (85% leased) in Lakewood, Col.; $13 mil. for Cumberland Metro Office Park near O'Hare Airport in Chicago, 52% leased but holding long-term values. MYM also formed two joint ventures to buy warehouse/industrial properties near Atlanta. Equities are 51% office, 35% retail, 14% warehouse.

Financial Measures - A: Debt of $97.8 mil. at Aug. 31 is 1.0 times $97.8 mil. equity, equal to $9.49/sh. Debt is 72% commercial paper, 20% intermediate-term debt due 1990. Liquidity is good.

Current value: MYM's equities are appraised independently at $15.4 mil. or about $1.50/sh. over book value.

Exposure - B: MYM is reducing exposure to interest rate swings and building longer-term equity values.

NEW LISTINGS IN RSR: SIERRA CAPITAL REALTY IV AND OAKWOOD HOMES JOIN LIST

Sierra Capital Realty Trust IV (8-1/2--OTC) is the largest of the Sierra Capital trusts to become fully funded and invested. Sierra IV sold 7.5 mil. shs. at $10 per sh. in a best efforts offering completed Mar. 12, 1986 to raise $75 mil. Shs. trade on NASDAQ under the SETD symbol. The offering included 3.01 mil. wts. to buy shs. at $9.50/sh. thru June 30, 1988. SETD is a finite life REIT which intends selling its properties and liquidating in 10-12 years. We are not ranking SETD until its operating record emerges.

Sponsor: SETD is sponsored by Sierra Capital Cos. of San Francisco, which manages three other operating REITS and is offering a fifth, Sierra Capital Realty Trust VI. All told Sierra has raised $205 mil. for its REITs and purchased 6 mil. sq. ft. of property, which is 95% leased. Sierra specializes in industrial/distribution and research & development space, which account for about 65% of space. About 33% is retail and 1.5% in offices.

CFS/Dividends: SETD earned 20.6¢ under general accounting principles in the six months thru June 30, vs. no meaningful comparisons. Net cash flow was 22.2¢ sh. on average shs. Dividends of 5.42¢ are paid monthly, equal to a 65¢ annual rate or 6.5% on offer price. About 45.5% was tax-free return in 1985.

Assets and Operations: SETD has purchased interests in 14 properties with 1.58 mil. sq. ft. divided by SF 37% distribution, 35% industrial, 17% business service centers, 7% shopping centers, and 4% office. Properties are completed buildings generally bought from nationally known realty developers (Trammell Crow partnerships are frequent sellers to Sierra). SETD properties are 98% leased, including master leases on a small amount of Dallas properties. By location of space purchased to date, 49% is Dallas area, 36% Chicago, 7% Ft. Worth, and 8% San Francisco area. SETD also plans adding by year-end about 850,000 SF light industrial and office/showroom space in Chicago, Cherry Hill, N.J. and Phoenix. SETD buys to yield 9%-9.5% cash on cash and purchase prices have been running $22-$45/SF for warehouse/distribution/industrial space depending on office finish; $80-$110/SF for business park and retail space.

Financial Measures: Debt and capitalized lease obligations of $23.6 mil. at June 30 was 0.37 times shareholders' equity of $63.5 mil. or $8.46/sh. All debt is secured by properties. Goal is to operate with modest leverage of about 0.5 times equity.

Exposure: By concentrating on industrial properties where national vacancy rates are low (5.7% now) and leases are generally five years or longer, SETD hopes to avoid problems found in overbuilt office markets.

Here are brief ranking reviews of two earlier Sierra trusts:

Sierra Real Estate Equity Trust '83 (9-3/4--SETBS--OTC) is Ranked B in our first Ranking. SETBS was added to RSR in Aug. 1984. It is also a finite life equity REIT.

EPS/Dividends - B: Like other equity trusts, SETBS' performance is best measured by operating cash flow before and after debt service, and by distributions. The following comparison of per-share results shows cash flows down a bit in 1985 while new properties were still being added, but rising in the first half of 1986. Net cash flow is about 74% of distributions in 1986's first half; no capital gains have been realized. The distribution is expected to be 30%-40% sheltered in 1986. Recent per-share results compared to earlier periods are:

	Year 1985	% Chg.	6 Mo. 1986	% Chg.
Operating cash flow before debt ser.	$0.525	-5%	$0.29	+13%
Operating cash flow after debt serv.	$0.44	-14	$0.24	+13
Distributions....	$0.64	+7	$0.325	+4

Assets and Operations: SETBS owns equity interests in seven properties with 1.19 mil. SF, divided 49% distribution, 20% research/development, 15% business centers, 10% industrial, and 6% shopping center. Space is 96% occupied.

Financial Measures - A: Debt of $16.3 mil. is 0.7 times $22.3 mil. equity, equal to $7.32/sh. Depreciation

equals 56¢ sh. SETBS has 91,403 wts. outstanding to buy shs. at $9.50 thru Jan. 15, 1987.

Current Value: Independent appraisers put current value at $10.98/sh.

Sierra Real Estate Equity Trust ´84 (9-1/4--SETC--OTC) also wins B Rank in our first ranking. This finite life REIT joined RSR July 26, 1985.

EPS/Dividends - B: SETC´s gross and net operating cash flow and distributions all declined in the first half of 1986, because initial returns on new real estate investments were below yields on temporary cash investments. Results on a per-share basis are:

	Year 1985	% Chg.	6 Mo. 1986	% Chg.
Operating cash flow before debt serv.	$0.37	+30%	$0.14	-31%
Operating cash flow after debt serv.	$0.355	+32	$0.136	-31
Distributions....	$0.725	+32	$0.30	-14

Distributions were 100% tax sheltered in 1985. SETC has refinanced five properties and expects to refinance a sixth to boost 1987 cash flow to about 49¢ sh.

Assets and Operations: SETC owns equity interests in seven properties with 1.2 mil. SF, which are 52% business service centers, 38% shopping centers, and 10% industrial. Properties are located in Calif., Hawaii and Ariz. About 95% of space is occupied.

Financial Measures - A: Debt of $35.6 mil. (all mortgages) at June 30 is 1.0 times $36.2 mil. equity or $7.42/sh. Accumulated depreciation is 43¢. SETC has 454,198 wts. out to buy shs. at $9.50 thru June 30, 1987.

Current value: Appraisers value SETC at $8.78/sh. at Dec. 1985.

Oakwood Homes Corp. (16-1/--NYSE), Greensboro, N.C. mobile home retailer and manufacturer, is added with an initial rank of A. Shares trade under OH symbol.

EPS/Dividends - A: OH earned $1.41 sh. in its Sept. 1985 year before a 17¢ unusual charge for a stock gift to the president. EPS have risen at 17.5% over the past five years. EPS fell 1% in the nine mon. thru June to 86¢, reflecting weak sales in Texas, costs of repossessions, and general flat sales. OH pays 8¢ annually and dividends have risen at 15% annually.

Assets and Operations: OH is a vertically integrated company that builds mobile homes at four plants in the Southeast (one recently brought on stream) and retails thru 61 retail lots. It also operates finance and insurance subsidiaries. OH´s key markets are N.C., S.C., Va., Tenn. and W.Va. OH closed two sales centers in Tex. (where sales plunged 57% in June) during the June qtr., leaving six there. OH plans opening 12 new centers by year-end, entering Ky., Del. and Md. Oakwood homes have a quality image in its area, while the recently begun Freedom line is an entry in lower priced starter markets. OH manufactured 4,462 homes in FY 1985 and sold 5,603 DU (5,056 new) at retail and wholesale. Repossessions fell 35% in the June qtr. to 177 DU and sales of 277 DU cut inventory by 100.

OH is developing three mobile home communities with approx. 1,000 DU.

Financial Measures - A: Debt of $29 mil. is 0.6 times equity of $51.8 mil. or $11.33/sh. Debt is mainly $25 mil. of 7.5% debentures, convertible at $29 and due 2001. Insiders own about 10%.

Exposure - B: OH´s vertical integration has aided profit and sales growth, although it is not immune to sluggish industry sales (RSR, Oct. 10). The ASE-listed converts offer an interesting play for conservative investors.

COMPARATIVE REALTY STOCK GROUP AVERAGE 11/05/86

GROUP NUMBER & NAME	DIV	NON-DIV	TOTAL	SHARE (000)	BOOK VALUE	ANNUAL DIV	EARN ANN	LAST PRICE	-% CHANGE FROM OCT 22	JAN 1	P/E RATIO	ANNUAL YIELD	% PR TO BK	RETURN ON BK	MARKET VAL(000)
1 PROPERTY REITS	43	4	47	6277	11.00	1.20	1.14	15.81	0.8	11.3	13.9	7.6	43.7	10.3	5053.4
2 PROP & MTG COMB REITS	22	2	24	5714	12.84	1.39	1.06	14.84	0.8	1.9	14.0	9.4	15.6	8.3	2142.8
3 MORTGAGE REITS	16	1	17	5157	15.33	1.58	2.85	16.18	0.7	10.1	5.7	9.8	5.6	18.6	1578.0
4 PARTICIPATING MTG REITS	12	0	12	8220	12.64	1.20	1.25	13.50	0.4	1.0	10.8	8.9	6.8	9.9	1463.9
5 MAJOR HOMEBUILDERS	8	4	12	16906	10.62	0.26	1.49	19.98	2.8	38.8	13.4	1.3	88.1	14.0	3383.1
6 OTHER BLDRS/DEVELOPERS	9	26	35	6040	5.74	0.13	0.27	8.94	5.7	5.5	32.7	1.4	55.6	4.8	1946.7
7 INCOME PROP BLDR/OWNR	15	11	26	5870	11.11	0.55	1.01	18.34	-1.6	11.2	18.1	3.0	65.1	9.1	3256.6
8 MORTGAGE BANKER/FINANCE	11	5	16	11793	11.22	0.77	1.04	16.05	1.9	6.7	15.5	4.8	43.1	9.2	4532.4
9 DIVERSFIED RLTY&HOLDING	13	8	21	22518	13.25	0.30	0.95	18.53	1.0	17.2	19.5	1.6	39.9	7.2	14242.9
10 RLTY SVCS/SYNDICATORS	2	4	6	8186	6.61	0.04	-0.09	9.06	3.6	-13.0	0.0	0.4	37.2	-1.4	400.5
11 MANUFACTURED HOUSING	4	6	10	12275	6.29	0.14	0.37	8.88	2.6	-15.1	24.0	1.6	41.0	5.9	1089.5
L LIQUIDATING COMPANIES	1	0	1	5954	2.22	0.19	-1.02	4.75	-7.3	-26.9	NC	NC	114.0	NC	28.3
P PREFERRED STOCKS	2	0	2	1923	11.25	0.93	0.00	14.69	1.3	12.4	NC	NC	30.6	NC	57.4
OVERALL AVERAGE			229	8933	10.68	0.77	1.04	14.84	1.2	9.4	14.2	5.2	38.9	7.2	39175.5
DOW JONES INDUSTRIALS							103.39	1899.04	5.0	22.8	18.4	3.6			
STANDARD & POOR´S 500							14.89	246.58	4.4	16.7	16.6	3.4			
DOW JONES UTILITIES							13.95	210.44	5.5	20.4	15.1	7.5			